

MLC-Platinum Global Fund

QUARTERLY INVESTMENT MANAGER'S REPORT

PERFORMANCE

Fund Size: \$952.4m	Last quarter	Last 12 months	5 years (compound pa)	Since inception (compound pa)
MLC-Platinum Global Fund	3.8%	12.5%	13.3%	11.0%
MSCI All Country World Net Index (A\$)	1.5%	16.0%	15.2%	6.6%

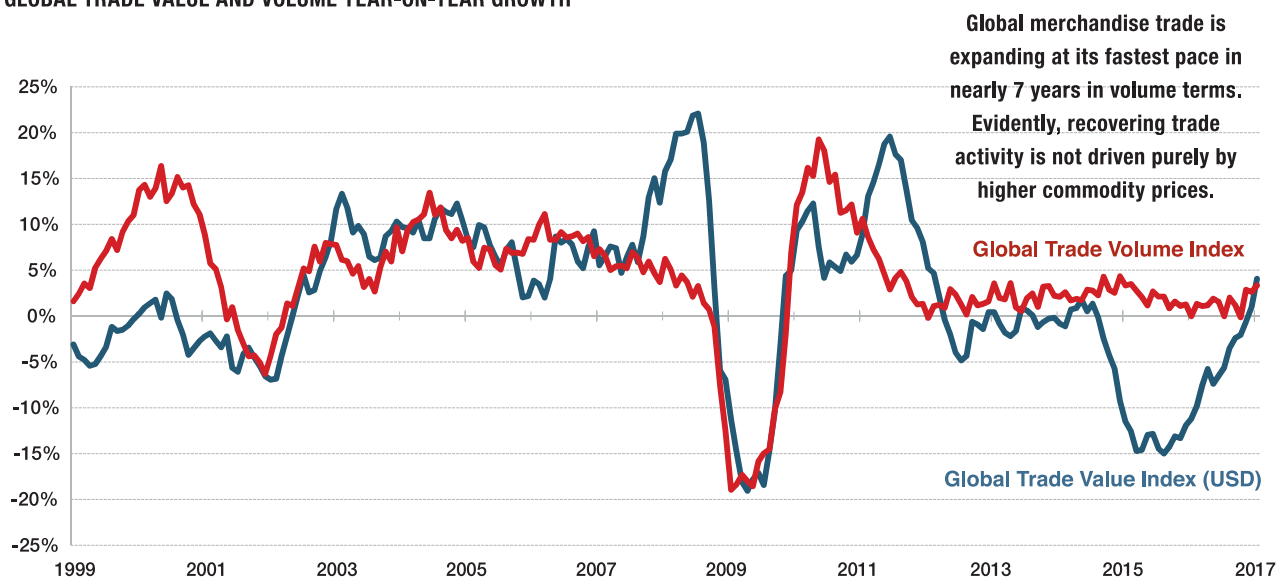
Source: MLC Investments Limited, Platinum Investment Management Limited, and MSCI Inc. Past performance is not indicative of future performance. The value of an investment may rise or fall with the changes in the market.

PERFORMANCE

In general, one can characterise the **last quarter as one of positive or improving economic news**. This ranged from rising Purchasing Managers' Indices (PMIs) across the globe to hitherto dull spots like Brazil and Russia looking brighter. China exceeded even the optimist's expectations with an acceleration of industrial production and investment, even as the government pressed for closure of redundant capacity in heavy industries like steel and cement. For those harbouring doubts about surveys, do take note that **world merchandise trade is expanding at its fastest pace in seven years** (see chart below).

This broad-based expansion, together with evidence of improving profits, led markets considerably higher, with the **emerging markets taking leadership for the first time in six years**. Throughout these three months there was turbulent inter-sector and inter-market rotation. Importantly, the rise was against a backdrop of the US administration struggling to pass legislation, elections in Europe, the UK commencing the formal process to leave the European Union (EU), and a presidential impeachment in Korea. It was also accompanied by short-term interest rates lifting in the world's two largest economies, China and America. The Fed raised the federal funds rate in March by 25 basis points and the interbank rate in Shanghai has risen by a full 1% since December 2016.

GLOBAL TRADE VALUE AND VOLUME YEAR-ON-YEAR GROWTH



Source: Bloomberg

MLC-Platinum Global Fund (

This turn of events plays well to our positioning and this is starting to show in our relative returns with the Fund achieving 3.8% for the quarter, an outperformance of 2.3%, though performance still trails for the year with 12.5% versus 16% by the MSCI AC World Index. As we constantly remind investors, our aim is to achieve strong positive returns over time and, to do this, we meld fundamental research with quantitative modelling. It is by this method that we have arrived at a disposition of the portfolio which is completely different to that of the MSCI index, with a heavy weighting in Asia and a low weighting in the US.

Current valuations of the US market – at 2 standard deviations from fair value – should be considered expensive under most circumstances, whereas the markets we favour offer fair to good value. For example, the US market is on a cyclically adjusted P/E of 28 times, while the developed world, ex the US, is on 18 times and emerging markets are on 15 times.

The holdings that had a strong positive influence on the Fund's performance this quarter included 58.com (+26%), Skyworks (+32%), Cisco (+13%), Reliance Industries (+22%), Jiangsu Yanghe Brewery (+25%) and ENN Energy Holdings (+37%). Detractors were the energy-related stocks, including Inpex (-6%), TechnipFMC (-9%) and Eni (-1%), and some financials like PICC (-1%).

SHORTING

We reduced the short index positions early in the quarter in response to ongoing positive surprises. This involved closing the put options and reducing index shorts.

CURRENCY

There were few changes to our currency positions. Exposure to the Korean won rose in tandem with underlying stock purchases while we actively cut the positions in the Norwegian krone and the British pound. The higher holding of the Australian dollar was helpful, on balance, for the quarter.

FUND'S CURRENCY EXPOSURE

Currency	31 Mar 2017	31 Dec 2016
Australian dollar (AUD)	20%	20%
US dollar (USD)	17%	21%
Euro (EUR)	14%	15%
Hong Kong dollar (HKD)	10%	10%
Korean won (KRW)	9%	6%
Norwegian krone (NOK)	8%	10%
Indian rupee (INR)	6%	5%
Japanese yen (JPY)	5%	2%
British pound (GBP)	3%	5%
Chinese yuan (CNY)	3%	2%

Source: Platinum Investment Management Limited

MSCI REGIONAL INDEX PERFORMANCE TO 31.3.2017 (AUD)

Region	Quarter	1 year
Developed Markets	1%	16%
Emerging Markets	6%	18%
United States	1%	18%
Europe	2%	11%
Germany	3%	15%
France	2%	13%
United Kingdom	0%	8%
Japan	-1%	15%
Asia ex Japan	8%	18%
China	7%	21%
Hong Kong	8%	18%
India	11%	19%
Korea	11%	22%
Australia	5%	22%

Source: MSCI Inc

MSCI ALL COUNTRY WORLD SECTOR INDEX PERFORMANCE TO 31.3.2017 (AUD)

Sector	Quarter	1 year
Information Technology	7%	26%
Health Care	3%	9%
Consumer Discretionary	2%	12%
Materials	2%	27%
Industrials	2%	17%
Consumer Staples	2%	5%
Utilities	1%	5%
Financials	0%	26%
Telecommunication Services	-3%	1%
Energy	-9%	16%

Source: MSCI Inc

Quarterly Report (Continued)

CHANGES TO THE PORTFOLIO

All of the Fund's holdings in **Level 3 Communications** and **Carnival Corp** have now been sold, having reached our price objectives. We trimmed **Lloyds Bank** and **ICICI Bank** on improved recovery expectations as well as other holdings like Chow Tai Fook, Daimler and Sanofi. We also trimmed Samsung Electronics as it continued to run on rising expectations around its performance in mobile sales and as a component supplier of memory chips and OLED screens.

There was a fair amount of topping-up of positions in the likes of Gilead (pharmaceuticals) as its price weakened, Nexon (computer games), as well as Lixil (building products) and Asahi (breweries) on our rising expectations of higher profits as they press forward with the integration of their recent acquisitions and rationalise their activities. The knock-on effect of the lower oil prices allowed us to increase our oil price-sensitive plays like TechnipFMC.

The two new holdings of significance are **Hyundai Motor** and **LG Chemical**.

Our quant models show decisively that the world's auto industry is as out-of-favour as it has ever been in **30 years**. This is despite high demand in the US, growing demand in other industrialised economies and now a recovery in the emerging market countries. Explanations vary from over-capacity to the threat of car-pooling and the shared economy, disruption by electric vehicles and autonomous vehicles as well as the impact of a possible US border tax. There are also niggling issues regarding residual values and defaults on the leasing books in the US as auto manufacturers have progressively won market share in auto loans at the expense of banks.

FUND'S DISPOSITION OF ASSETS (NET INVESTED POSITION)*

Region	31 Mar 2017	31 Dec 2016
Asia	34.9%	29.6%
Europe	22.8%	24.3%
Japan	15.8%	13.0%
North America*	10.4%	12.2%
Australia	0.8%	0.7%
Russia	0.6%	0.8%
Cash	14.7%	19.4%

Source: Platinum Investment Management Limited

* The net invested positions represent the Fund's exposure to company securities and both long and short derivatives as a percentage of the Fund's net asset value.

* At 31 March 2017, the Fund had a short position in the US against the S&P 500 Index of -8.0% (31 December 2016: -7.2%) and a position against the Russell 2000 Index of -1.0% (31 December 2016: -2.6%).

This led us to a thorough review of the choices on offer and **Hyundai** stood out for us as one of the more prospective plays. We can point to its supposed superior loan book in the US, which will be important, but essentially it is a company with an unmatched growth record. We like its current product line-up, where SUVs are now all the rage, and the fact that it is disproportionately exposed to important emerging markets. With plants in Russia, China, India and Turkey, there is every prospect of a strong recovery in profits as these markets recover and grow. Seldom do stock stories come without blemishes, and then it comes down to assessing the relative merits of the risks, growth trajectories and valuations. Net of the cash sitting atop its manufacturing activities, Hyundai is now priced as cheaply as it was during the GFC.

LG Chemical is in a way related to the above case. It is the world's **leading supplier of electric vehicle batteries** and has supply arrangements with virtually all the major auto companies, led by an interesting reciprocal arrangement with GM. As the change from internal combustion engine to electric drivetrain accelerates, aided by mandated fleet emission standards and subsidies, there will surely be intense competition in the supply chain. But as we have seen in other parts of the auto industry, there has been a consolidation of suppliers and scale will be of paramount importance. There are ambitious targets to be met, like raising the capacity of these batteries from around 250 wh/kg to 300 wh/kg and dropping the cost from some US\$150 per kWh today to US\$125 by 2020. The commitment by LG Chem is huge and involves over 10% of its employed capital and a greater proportion of its R&D budget, with profits still a promise!

TOP 10 HOLDINGS

Stock	Country	Industry	Weight
Samsung Electronics	Korea	IT	4.0%
Alphabet Inc	USA	IT	3.2%
Tencent Holdings	China Ex PRC	IT	2.8%
Lixil Group Corporation	Japan	Industrials	2.6%
Eni SpA	Italy	Energy	2.3%
Sanofi SA	France	Health Care	2.2%
Kering	France	Consumer Disc	2.2%
Inpex Corporation	Japan	Energy	2.1%
AstraZeneca Plc	UK	Health Care	2.1%
KB Financial Group	Korea	Financials	2.0%

As at 31 March 2017. The table shows the Funds' top ten long stock positions (including derivatives) as a percentage of the Fund's net asset value.

Source: Platinum Investment Management Limited.

Its traditional chemical activities are prone to cyclicalities and issues around marginal investment by the chemical industry in China. This could work to the company's favour as, for example, one third of China's PVC production is manufactured from a highly polluting coal-based process, closure of which could sustain the construction-induced cyclical uptrend in PVC prices. Despite this, LG Chem's shares are trading at close to half of their 2011 peak when the first surge of excitement around the auto battery business drove sentiment. Subsequently, the shares have become a 'show-me' situation as disaffected early owners wilted. Given the company's historical record, the shares at their current price are worth owning without the battery story, but if this bears fruit, the reward could be a handsome one.

OUTLOOK

We have been emphasising for some time that there has been a huge divergence in the performance of the emerging markets versus the developed markets, with the US streaking ahead of all others. This may have now reached an extreme and the time has come for the other markets to play catch-up. If one thinks about the cause of the emerging markets' problems, they reach back to 2009 when these countries introduced aggressive stimulus to offset weakening demand caused by the GFC. This in turn resulted in the completion of grand projects with associated increases in supply and, later, overheating. As the authorities moved to reverse and tighten policy, companies experienced the combined hits of rising interest rates, falling commodity prices, exacerbated by the new drilling and fracking practices on the shale fields, and plummeting profits. Weak commodity prices were a boon to the developed markets and, likewise, a burden on the largely commodity-dependent emerging markets, hence the great divergence.

Galloping world trade and the concomitant improvements in the demand for commodities have reinvigorated the emerging markets and profits in 2016 started to outpace those of the developed countries. With their traditionally higher growth rates, this will be reflected in profit growth, but most important of all, the **free cash flow will be far superior to what they were in the last cycle, because of lower capital needs.** Combine this with very modest price inflation and the prospect of more stable interest and exchange rates, and the case is made for significant outperformance in the months ahead. We believe Asia will be at the forefront of this tide, be it Japanese or Korean exporters or the domestic plays in the rest of Asia. With valuations being so disparate, it is likely that the equity markets will reflect this new divergence in distributable profits, and this will reverse investment flows.

Kerr Neilson
Managing Director
Platinum Asset Management

This report is intended to be read in conjunction with a macro overview and general market commentary written by Andrew Clifford, CIO of Platinum Asset Management.

A copy of Andrew's commentary can be viewed at www.platinum.com.au/journal/

If you have any questions about your investment in the MLC-Platinum Global Fund, please contact the MasterKey Service Centre on

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Platinum Asset Management is an Australia based international fund manager.
For greater insight into our process, please visit our website at www.platinum.com.au

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